

class of the leased property (taking into account any election by the lessor or lessee under section 168(b)(3)) shall reduce the amount the lessor is considered to have at risk by the amount of the option price at the time the option becomes exercisable.

§ 5c.168(f)(8)-5 Term of lease.

(a) *Term of lease—Basic rules.* To qualify as a lease under section 168(f)(8) and § 5c.168 (f)(8)-1 (a), the lease agreement must provide for a term that does not exceed the maximum term described in paragraph (b) of this section; such term must also at least equal the minimum term described in paragraph (c).

(b) *Maximum term.* For purposes of section 168(f)(8)(B)(iii) and this section, the term of the lease may not exceed the greater of—

(1) 90 percent of the useful life of the property under section 167, or

(2) 150 percent of the asset depreciation range (ADR) present class life (“midpoint”) of such property, applicable as of January 1, 1981 (without regard to section 167(m)(4)), published in Rev. Proc. 77-10, 1977-1 C. B. 548, and revisions thereto.

Solely for purposes of this paragraph (b), “useful life” means the period when the leased asset can reasonably be expected to be economically useful in anyone’s trade or business; such term does not mean the period during which the lessor expects to lease the property. Any option to extend the term of the lease, whether or not at fair market value rent, must be included in the term of the lease for purposes of this paragraph. If several different pieces of property are the subject of a single lease, the maximum allowable term for such lease will be measured with respect to the property with the shortest life. In no case, however, will the lease term qualify under this section if such term with respect to any piece of property is less than the minimum term described in paragraph (c).

(c) *Minimum term.* For purposes of this section, the term of the lease must at least equal the period prescribed under section 168(c)(2) for the recovery property class of the leased property. For example, if a piece of leased equipment is in the 5-year recovery property class, the lease agreement must have a

minimum term of 5 years. In general, the determination of whether property is 3-year recovery property, 5-year recovery property, etc., in the hands of the lessor will be based on the characterization of the property in the hands of the owner as determined without regard to the section 168(f)(8) lease. Thus, for example, property which is public utility property or RRB replacement property absent the section 168(f)(8) lease will be characterized as such in the hands of the lessor for purposes of section 168(f)(8). However, with respect to RRB replacement property, the transitional rule of section 168(f)(3) shall be inapplicable to the lessor. In addition, any election under section 168(b)(3) by the lessor with respect to the class of recovery property to which the qualified leased property is assigned shall apply to the leased property in determining the term of the lease. A lease term that does not exceed the term required to satisfy the minimum lease term of this paragraph will be deemed to comply with the maximum lease term described in paragraph (b) if such minimum lease term exceeds such maximum lease term.

(d) *Examples.* The application of this section may be illustrated by the following examples:

Example (1). X Corp. (as lessee) and Y Corp. (as lessor) enter into a lease which they elect to be treated under section 168(f)(8) with respect to a chemical manufacturing facility that will also generate steam for use in the production of electricity. The assets comprising the chemical plant are described in ADR guideline class 28.0 (midpoint life of 9.5 years), and the assets comprising the steam plant are described in ADR class 00.4 (midpoint life of 22 years). To satisfy the maximum lease term requirement of section 168(f)(8)(B)(iii)(II) and § 5c.168 (f)(8)-5(b), the lease term may not exceed 14.25 years (150 percent of the 9.5 year midpoint life of the chemical plant).

Example (2). The facts are the same as in example (1) except that the chemical plant and the steam plant are the subject of separate leases. For purposes of section 168(f)(8)(B)(iii)(II) and § 5c.168(f)(8)-5 (b), the maximum term of the lease with respect to the chemical plant is 14.25 years (150 percent of 9.5 years) and the maximum term of the lease with respect to the steam plant is 33 years (150 percent of 22 years).

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